

Press Release

15 May 2017

### Completed investigation

On 11 May 2017, the FRC adopted the investigation report on the audit of the consolidated financial statements of a listed entity for the year ended 31 March 2011 (**the Relevant Financial Statements**).

The Audit Investigation Board (**the AIB**) found that the auditor failed or neglected to observe, maintain or otherwise apply a number of professional standards in the audit concerning a number of financial instruments and the assessment of the going concern assumption in preparing the Relevant Financial Statements.

The investigation report has been referred to the Hong Kong Institute of Certified Public Accountants (**HKICPA**) to determine if any disciplinary actions are warranted.

On 28 May 2013, the FRC directed the AIB to conduct an investigation on the audit of the Relevant Financial Statements.

As a result of the investigation, the AIB found the following auditing irregularities:

(a) *Classification and measurement of convertible bonds (CB1)*

The listed entity was unable to redeem CB1 upon maturity and failed to satisfy all the conditions for an extension in redemption at the year-end. The auditor failed to identify that CB1 should be classified as current liabilities, consider the financial effect on modification of repayment terms and prepare adequate audit documentation in accordance with paragraph 6 of Hong Kong Auditing Standard (**HKSA**) 500 *Audit Evidence* and paragraph 10 of HKSA 230 *Audit Documentation*.

(b) *Recognition and classification of subordinate convertible notes (SCN)*

The listed entity was required to redeem the outstanding SCN upon maturity by issuance of its own shares at the higher of the market price at the maturity date and a specified conversion price. The auditor failed to obtain sufficient appropriate evidence to identify that SCN should not be recognised and classified as equity instruments in accordance with paragraph 6 of HKSA 500.

(c) *Measurement of another convertible bonds (CB2), convertible preference shares (CPS) and share options granted to employees*

The auditor failed to obtain sufficient evidence in respect of the fair value measurement of the derivative component of CB2 in accordance with paragraph 6 of HKSA 500, and did not sufficiently document their evaluation of the relevance and reasonableness of the significant assumptions and methods used by the valuer in determining the fair values of the derivative components of CB2 and CPS, and the share options in accordance with paragraph 8 of HKSA 230.

(d) *Assessment of the going concern assumption*

The Relevant Financial Statements had been prepared on a going concern basis with a number of specific measures aimed at improving the listed entity's financial and liquidity position. The auditor failed to obtain sufficient appropriate audit evidence to evaluate the appropriateness of management's assessment in accordance with paragraphs 12, 14 and 16 of HKSA 570 *Going Concern*.

The AIB found that the engagement quality control reviewer did not fully comply with paragraph 20 of HKSA 220 *Quality Control for an Audit of Financial Statements* in performing the engagement quality control review as she should have identified the above audit deficiencies.

Based on the above, the engagement partner and the engagement quality control reviewer failed to maintain professional knowledge and skill at the level required and act diligently in accordance with the applicable technical and professional standards in accordance with section 130.1 of the Code of Ethics for Professional Accountants.

On 11 May 2017, the FRC adopted the investigation report prepared by the AIB, which summarised the findings of the investigation. The investigation report has been referred to the HKICPA to determine if any disciplinary actions are warranted. Names of the relevant parties are withheld pending the conclusion of such disciplinary proceedings, if any.

The AIB is chaired by the Chief Executive Officer and its members are full-time staff of the FRC.

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## **Note to editors**

### **About the FRC**

The FRC is a statutory body established in December 2006 under the Financial Reporting Council Ordinance. The FRC is entrusted with the statutory responsibilities to conduct independent investigations into possible auditing or reporting irregularities in relation to listed entities and to enquire into possible non-compliance with accounting requirements on the part of listed entities. The FRC has 11 members with a variety of professional backgrounds and the majority of whom, including the Chairman, are lay persons. For more information, please visit [www.frc.org.hk](http://www.frc.org.hk).

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